Consolidated Statement of Earnings

(In thousands, except per share data)	Year Ended July 30, 1988	Year Ended August 1, 1987	Twenty-six Week Period Ended August [illegible] 1987	Year Ended January 31, 1987	Year Ended February 1, 1986
		(unaudited)			
Sales	$2,617,143	$2,869,205	$1,164,338	$2,995,977	$2,889,950
Cost of goods sold, including occupancy and buying costs	1,879,664	2,163,005	919,764	2,168,653	2,123,185
Selling, general, and administrative expenses	587,869	732,863	349,185	685,680	660,346
Gain on sale of shopping center interest	30,600				
Costs of operational and facility realignment programs	28,500	15,700	15,700		
Loss on sale of John Wanamaker		6,200	4,000	2,200	
Direct costs relating to restructuring program		40,750	15,750	25,000	
Other restructuring costs		7,400	7,400		
Earnings (loss) from continuing operations before interest expense and income taxes	151,110	(96,713)	(147,461)	114,444	106,419
Interest expense	135,600	67,370	28,134	82,915	91,203
Pretax earnings (loss) from continuing operations	15,510	(164,083)	(175,595)	31,529	15,216
Income taxes	6,200	(48,800)	(68,300)	26,500	(3,000)
Earnings (loss) from continuing operations	9,310	(115,283)	(107,295)	5,029	18,216
Discontinued operations, net of income taxes of $(28,350), $(56,800), $38,900, and $25,100		(34,115)	(63,578)	42,586	29,809
Earnings (loss) before extraordinary item and cumulative effect of changes in accounting	9,310	(149,398)	(170,873)	47,615	48,025
Extraordinary costs relating to early retirements of debt, net of income tax benefits of $1,210 and $28,804	(1,750)	(29,253)		(29,253)	
Cumulative effect of changes in accounting					
Capitalization of inventory costs, net of income tax expense of $10,440	10,100				
Expensing of computer software development costs, net of income tax benefit of $15,505				(14,148)	
Net earnings (loss)	$ 17,660	$ (178,651)	$ (170,873)	$ 4,214	$ 48,025
Primary earnings (loss) per common share					
Continuing operations	$ .33	$ (7.24)	$ (6.06)	$ (1.23)	$ (.60)
Discontinued operations		(1.70)	(3.15)	2.10	1.52
Extraordinary costs related to early retirements of debt	(.08)	(1.46)		(1.44)	
Changes in accounting					
Capitalization of inventory costs	.47				
Expensing of computer software development costs				(.70)	
	$ .72	$ (10.40)	$ (9.21)	$ (1.27)	$ .92

See accompanying Summary of Significant Accounting Policies and Financial Review.

Consolidated Balance Sheet

(In thousands)	July 30, 1988	August 1, 1987
Assets		
Current assets		
Cash	$ 24,643	$ 14,885
Accounts receivable, net	473,826	546,819
Merchandise inventories	536,656	432,866
Deferred income taxes	11,825	12,513
Other current assets	27,833	28,847
	1,074,783	1,035,930
Property and equipment, net	535,661	502,083
Other assets	61,178	33,635
Net assets of the specialty store divisions		350,438
	$1,671,622	$1,922,086
Liabilities and Shareholders' Equity		
Current liabilities		
Current installments	$ 4,364	$ 7,342
Accounts payable	306,846	219,721
Accrued liabilities	177,648	224,624
Current income taxes	12,867	12,119
	501,725	463,806
Long-term debt	1,177,248	769,820
Capital lease obligations	83,168	112,042
Other liabilities	62,042	42,217
Long-term deferred income taxes	77,630	88,429
Redeemable preferred stock		300,000
Common stock, $.01 par value ($5 par value at August 1, 1987)	226	101,837
Other paid-in capital	581,349	174,404
Accumulated deficit	(811,766)	(130,469)
	$1,671,622	$1,922,086

See accompanying Summary of Significant Accounting Policies and Financial Review.

Consolidated Statement of Cash Flows

(In thousands)	Year Ended July 30, 1988	Year Ended August 1, 1987 (unaudited)	Twenty-six Week Period Ended August 1, 1987	Year Ended January 31, 1987	Year Ended February 1, 1986
Operating activities					
Earnings (loss) from continuing operations	$ 9,310	$(115,283)	$(107,295)	$ 5,029	$ 18,216
Depreciation and amortization	51,829	57,851	24,311	55,285	54,154
Gain on sale of shopping center interest	(30,000)				
Deferred income taxes	(22,900)	(14,664)	(48,602)	26,320	(2,974)
Loss, net of income taxes, on sale of John Wanamaker		6,700		6,700	
Change in operating assets and liabilities					
Accounts receivable, net	72,993	(111,893)	(26,123)	21,715	22,028
Merchandise inventories	(103,790)	116,451	65,058	52,315	(52,740)
Accounts payable and accrued liabilities	40,149	150,250	80,305	(48,091)	70,796
Other, net	8,279	(19,049)	(5,361)	(24,831)	(12,841)
Net cash provided (used) by					
Continuing operations	25,870	70,363	(17,707)	94,442	96,639
Discontinued operations		(72,660)	69,077	(131,464)	62,192
	25,870	(2,297)	51,370	(37,022)	158,831
Investment activities					
Store property and equipment purchased	(80,205)	(65,841)	(15,034)	(89,647)	(94,029)
Properties sold and retired	2,199	27,487	25,732	6,839	1,915
Sale of shopping center interest	32,000				
Elimination of John Wanamaker properties		80,243		80,243	
Change in investment in specialty store divisions		(37,620)	(196,867)	212,588	(69,257)
Net cash provided (used) by investment activities	(46,006)	4,269	(186,169)	210,023	(161,371)
Financing activities					
Increase (decrease) in notes payable	(537,000)	447,500	8,000	529,000	(83,179)
Issuances of long-term debt	1,162,929				250,000
Early retirement of long-term debt		(400,000)		(400,000)	
Costs relating to early retirements of long-term debt, net of items not requiring cash outlay	(1,750)	(23,173)		(23,173)	
Other retirements of long-term debt and capital lease obligations	(250,353)	(179,268)	(63,437)	(214,303)	(54,657)
Net change in debt allocated to the specialty store divisions		175,392	199,639	(26,931)	(72,945)
Issuances of common stock	4,587	22,859	13,593	14,894	12,062
Restructuring dividend of $17 per share	(346,464)				
Common and preferred stock dividends	(2,055)	(48,375)	(21,155)	(54,255)	(53,638)
Net cash provided (used) by financing activities	29,894	(5,065)	136,640	(174,768)	(2,357)
Net increase (decrease) in cash	9,758	(3,093)	1,841	(1,767)	(4,897)
Cash at the beginning of the period	14,885	17,978	13,044	14,811	19,708
Cash at the end of the period	$ 24,643	$ 14,885	$ 14,885	$ 13,044	$ 14,811

See accompanying Summary of Significant Accounting Policies and Financial Review.

Consolidated Statement of Common Stock and Other Shareholders' Equity

(in thousands)	Common Stock Shares	Common Stock Par Value	Other Paid-in Capital	Accumulated Earnings
Balance, February 2, 1985	19,067	$ 95,334	$140,358	$ 112,474
Net earnings				48,025
Cash dividends				
Common stock ($1.22 per share)				(23,638)
Redeemable preferred stock				(30,000)
Issuance of common stock under Employee Stock Ownership Benefit Plan	92	459	2,154	
Issuance of common stock under Dividend Reinvestment and Stock Purchase Plan	118	592	2,522	
Exercise of stock options	282	1,412	4,923	
Reversal of foreign currency translation adjustment				4,739
Balance, February 1, 1986	19,559	97,797	149,957	111,600
Net earnings				4,214
Cash dividends				
Common Stock ($1.22 per share)				(24,255)
Redeemable preferred stock				(30,000)
Issuance of common stock under Employee Stock Ownership Benefit Plan	67	337	2,057	
Issuance of common stock under Dividend Reinvestment and Stock Purchase Plan	97	485	3,040	
Issuance of common stock to Profit Sharing Plan	10	50	303	
Exercise of stock options	296	1,479	6,602	
Conversion of convertible debentures	13	65	476	
Balance, January 31, 1987	20,042	100,213	162,435	61,559
Net loss				(170,873)
Cash dividends				
Common stock ($.305 per share)				(6,155)
Redeemable preferred stock				(15,000)
Issuance of common stock under Dividend Reinvestment and Stock Purchase Plan	31	152	1,546	
Exercise of stock options	147	738	5,062	
Conversion of convertible debentures	147	734	5,361	
Balance, August 1, 1987	20,367	101,837	174,404	(130,469)
Net earnings				17,660
Cash dividends on redeemable preferred stock				(2,055)
Restructuring dividend of $17 per share				(346,464)
Change in common stock par value		(101,633)	101,633	
Conversion of redeemable preferred stock to common and preferred stock of The Neiman-Marcus Group			298,937	
Distribution of net assets of The Neiman-Marcus Group				(350,438)
Issuance of common stock under the 1987 Stock Incentive Plan	1,827	18	24,620	
Stock Incentive Plan contra*			(22,869)	
Exercise of stock options and other stock conversions	398	4	4,574	
Balance, July 30, 1988	22,592	$ 226	$581,349	$(811,766)

*Other Paid-in Capital is net of notes receivable and unamortized costs relating to the 1987 Stock Incentive Plan (see Employee Stock Incentive Plan footnote in the Financial Review).

See accompanying Summary of Significant Accounting Policies and Financial Review.

Carter Hawley Hale

About the Company

Carter Hawley Hale Stores, Inc. is one of the largest department store retailers in the United States. At the end of fiscal 1988, the company operated 112 stores in the growing Sunbelt regions of the country. The company conducts its business through the following five operating and two service divisions:

The Broadway–Southern California Los Angeles	Forty-three stores in Southern California
The Broadway–Southwest Phoenix	Eleven stores in Arizona, Colorado, Nevada, and New Mexico
Emporium Capwell San Francisco	Twenty-two stores in the greater San Francisco Bay Area
Thalhimers Richmond	Twenty-four stores in Virginia, North Carolina, South Carolina and Tennessee
Weinstock's Sacramento	Twelve stores in California, Nevada, and Utah
Information Services Anaheim	Provides information management and systems support for the company
Market Services New York	Responsible for the development of private label merchandise and large scale purchasing programs

Contents

Financial Highlights

(In thousands, except per share data)	Fifty-two weeks ended July 30, 1988	August 1, 1987*	January 31, 1987*	February 1, 1986*
Sales	$2,617,143	$2,869,205	$2,995,977	$2,889,950
Earnings from continuing operations before interest expense and income taxes	$ 151,110	$ (96,713)	$ 114,444	$ 106,419
Net earnings				
Continuing operations	$ 9,310	$ (115,283)	$ 5,029	$ 18,216
Discontinued operations		(34,115)	42,586	29,809
Extraordinary item	(1,750)	(29,253)	(29,253)	
Changes in accounting	10,100		(14,148)	
	$ 17,660	$ (178,651)	$ 4,214	$ 48,025
Primary earnings per common share				
Continuing operations	$ .33	$ (7.24)	$ (1.23)	$ (.60)
Discontinued operations		(1.70)	2.10	1.52
Extraordinary item	(.08)	(1.46)	(1.44)	
Changes in accounting	.47		(.70)	
	$ .72	$ (10.40)	$ (1.27)	$ .92

*Includes the results of John Wanamaker sold effective December 31, 1986.

Carter Hawley Hale made good progress on a number of fronts in its first year as a newly restructured company.

In a generally difficult retailing environment. marked by slower rates of increase in consumer spending across the country, the company improved its gross margins, expense performance and earnings before interest charges, and reduced outstanding debt by more than $50 million from the debt level immediately after the restructuring.

Net earnings for 1988 were $17.7 million, or $.72 per share, compared with a loss of $178.7 million, or a loss of $10.40 per share, in the prior year. Sales were $2,617.1 million compared with $2,600.1 million in 1987, after adjusting 1987 results to reflect the sale of John Wanamaker and two Broadway-Southwest stores. Comparative store sales increased .2 percent during the year.

The company continued its practice of investing in long-term programs, including customer service, store modernization, systems development, and operational enhancements and consolidations, the net effect of which is to improve both sales and expense efficiencies in the years ahead. In the face of a generally more difficult retail environment, we continue to believe that these investments in the company's long-term future predict to give it a base from which to compete and grow earnings at a better than competitive rate in the years ahead.

Improving levels of service to our customers continues to be the most important priority for all associates. Training activities in selling and service skills and product knowledge seminars were conducted both centrally and in each of our 112 stores as part of a comprehensive program to improve our competitive standing and to differentiate the customer's experience in our stores from our competitor's. These activities represent important commitments to the company, and we believe will contribute importantly to our prospective results.

Additionally, we continued investing in the improvement of our distribution facilities, with re-engineering taking place at four centers and additional major work commencing at the 2,000,000 square foot center in southern California. This last program will take approximately two and one-half years to complete, and is expected to reduce distribution costs and improve productivity in important ways.

The company's program of store modernization was accelerated. These modernization efforts are designed to improve the total store environment, make shopping easier, and re-allocate space to better support current and future merchandising programs. Enhanced lighting and new fixtures have been combined to improve sales productivity and performance. Work was completed on 14 stores during the past fiscal year, and plans call for improving 8 to 10 additional stores during the current year.

The benefits of these programs are being reflected in our expense performance. Selling, general and administrative expenses were down in absolute dollars and as a percentage of sales in 1988.

Significant Transactions

Two of our three Broadway–Southwest stores in Denver were sold on favorable terms during the first quarter of the year. Additionally, the company sold its interest in a shopping center in northern California while retaining its department store in that center. Proceeds from both transactions were used to reduce debt and for general corporate purposes.

Executive Changes

Early in the fiscal year, the company named Martin M. Kalkstein president and chief executive officer of The Broadway–Southwest. Mr. Kalkstein has been with the company since 1960, most recently as executive vice president, merchandising, at The Broadway–Southern California division.

Also during the early part of the year, Edward S. Waterbury retired from the company. Mr. Waterbury joined us in 1973 and was most recently a senior vice president. Near the end of the fiscal year E.J. Caldecott, vice president, real estate, legal, retired. Mr. Caldecott also joined the company in 1973.

Several corporate officer appointments were made during 1988. Brian L. Fleming, previously vice president, accounting, was named senior vice president, accounting and taxes. J. Scott Meyer, vice president, store planning, was promoted to senior vice president, store planning and construction. Larry G. Petersen, formerly vice president, planning and analysis, was named senior vice president, planning.

John S. Busey, treasurer, was named vice president, treasurer. William E. Dombrowski, director, media relations, was named vice president, corporate affairs. Joel E. Montgomery, formerly vice president, human resources, for the Information Services division was named vice president, human resources, at the corporate headquarters. Robert L. Turner, director, construction, was promoted to vice president, construction. Collette F. Ventrone, formerly vice president, store planning, design, and construction, for The Broadway–Southern California, was named vice president, store planning; and Gary J. Peterson joined the company as vice president, distribution.

At the end of this first year as a newly restructured company, I would like to express my appreciation to all of my associates across the entire corporation. They have worked with particular dedication, enthusiasm and ability to make possible the progress achieved, and to lay the foundation for future growth for the company and its shareholders.

Sincerely,

Philip M. Hawley

Philip M. Hawley
Chairman and Chief Executive Officer
October 10, 1988

Major efforts are underway to enhance merchandise presentation in our stores through modernization and remodeling programs. During the last year, Carter Hawley Hale significantly increased its expenditures for direct improvements on the selling floor. The goal is to have merchandise make a clear statement to the customer; to look tasteful, appealing, and exciting; and to convey the information our customers need in order to make purchase decisions.


The Broadway Southern California The Broadway Southwest
Thalhimers Weinstock's Market Services

Review of Operations

During the past year, Carter Hawley Hale focused on leveraging the integrated marketing approach it takes with its department stores and coordinating their operating procedures.

In this first annual report since the restructuring of the company, Philip M. Hawley, chairman and chief executive officer, and Waldo H. Burnside, president and chief operating officer, discuss these activities and some of the financial characteristics of the company.

What is the most important program Carter Hawley Hale has in place to continue improving its performance?

Mr. Hawley:
First and foremost is our effort to improve every aspect of customer satisfaction. We want each visit to our stores to be a satisfying shopping experience.

To accomplish this, we are working to change the culture in our stores to emphasize an increased sense of caring. Sales associates go through periodic training programs to improve their selling and communications skills. They are also provided with more extensive product knowledge than previously. And they participate in an incentive program that offers individual awards for sales achievements.

Merchandise assortments and visual presentation also play a major role in improved customer satisfaction. We have made progress on improving these two areas of our business and we will continue to focus on this in the coming year.

We've also reexamined and streamlined policies in our stores in order to enhance the shopping experience. We are making it easier to obtain credit, pay by check, and exchange merchandise. We are reducing the time it takes to get alterations completed and furniture delivered to the home.

This is not a short range one year effort, but rather a long-term process. We are pleased that customers tell us we are improving and making progress. This will continue to be an area that receives much focus and attention.

Mr. Burnside:
Part of customer satisfaction is having the right merchandise in the appropriate style, color, and size. In order to accomplish this, we now have more than 15 percent of our merchandise on an automatic replenishment system, with more being added each month. The system uses our advanced systems capability to keep us in stock in basic merchandise commodities such as hosiery, intimate apparel, and men's furnishings. Computer systems monitored by highly trained analysts track sales and automatically reorder by style, color, size, and branch store. Depending on the merchandise category, this system has significantly improved our in stock position, meaning our customers are able to find what they want when they want it.

What are some of the merchandise programs the company is undertaking to enhance profit?

Mr. Hawley:
In the men's furnishings area we have increased the amount of square footage to improve both the capacity and visual presentation of the merchandise. This has resulted in double digit improvements in our sales performance. We have programs in place in other fashion apparel categories and the decorative home area that predict to generate improved sales for the fall season.

Our private label program also continues to grow. We have had good success in a number of our private label brands, such as C.C. Courtenay, and will be lateralizing these name identifications across other merchandise categories.

Private label merchandise differentiates our stores from the competition, provides intrinsic value for our customers by combining high quality with value pricing, and improves our gross margin. It also lets us tailor our assortments to our customers' specific needs by filling voids in the existing marketplace.

Any other programs designed to drive sales and profits?

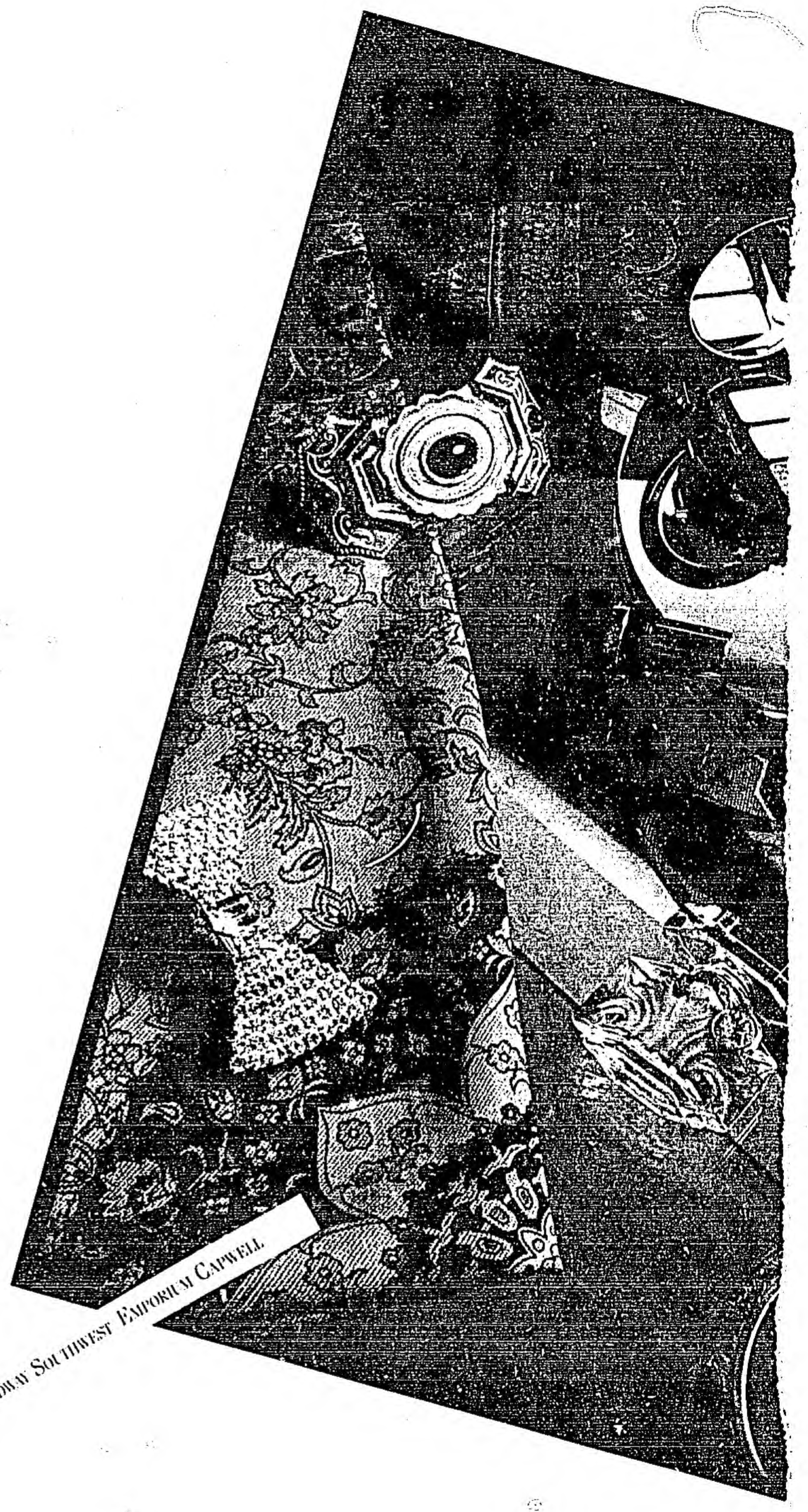
Mr. Hawley:
We have significantly increased the annual amount we are spending to modernize our stores to over $35 million. Renovations have been completed in 14 stores that improved the visual presentations and ambiance of the store environments, and we have scheduled another 8 to 10 stores for the current year. We are putting more excitement into the store environment, adding additional theatre to the shopping experience, and contributing to improved customer satisfaction.

Mr. Burnside:
One of our strengths is the large number of credit card accounts we have across the country. We have recently liberalized our credit terms and early results are encouraging. Our more flexible approach to credit management will lead to sales and profit growth in 1989.

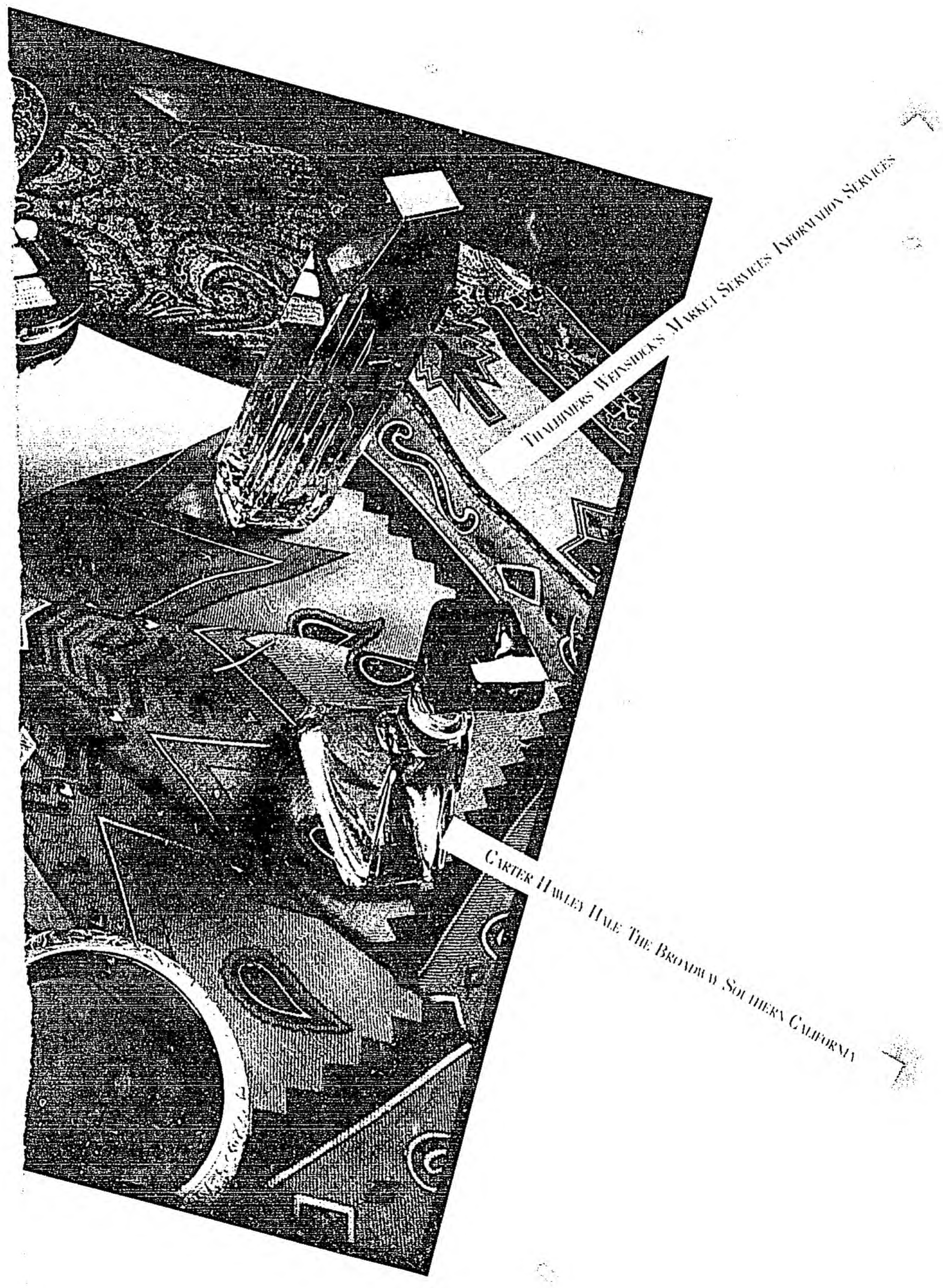
Carter Hawley Hale has one of the most advanced systems capabilities in retailing and we've touched on some of the things you are doing to leverage this competitive advantage. What else is going on in this area?

Mr. Burnside:
Our on-line unit control system allows every buyer to monitor sales, inventory, and outstanding orders by style, classification, vendor, and branch store. This helps us better manage our inventories, keeps us in-stock on best sellers, and spotlights trends that have peaked and may require earlier markdowns. We're also at the forefront of quick response, which is a term that covers electronic data interchange with vendors and the use of bar codes and scanning. Quick response will improve customer satisfaction and profitability once it becomes more broadly used. By transferring purchase orders electronically to the vendor we reduce the time it takes to receive fresh merchandise. Bar coding allows us to move merchandise more quickly through our distribution centers and to reduce the time it takes to complete a transaction on the sales floor. Bar coding and the use of wands to capture data also gives us more reliable sales information so that we can reorder the right merchandise.

Remodeling of departments creates opportunities for improvement in the presentation of merchandise through positioning of new fixtures. Brightly lit display cases, well designed racks, orderly haberdashery tables, and other merchandise fixtures when combined with improved lighting, wall treatments, visual aids, and floor coverings provide pleasing aesthetics that stimulate the customer and enrich the shopping experience.



THE BROADWAY SOUTHWEST EMPORIUM CAPWELL


Thalhimers Weinstock's Market Services Information Services
Carter Hawley Hale The Broadway Southern California

During the past year we installed a price look-up system in The Broadway–Southern California that centrally maintains current prices on merchandise. This decreased the average transaction time and improved profitability and customer satisfaction. It will be rolled out in the other divisions over the next 24 months.

Another development in this area is our customer interactive bridal registry system. Every store has at least one bridal registry kiosk and these were used by nearly one million customers during the last year. Using a touch sensitive screen, a customer calls up a printout with the couple's merchandise requests. After the purchase is made, the computer file is updated within 24 hours. The system also gives us information on these new households to target for other marketing programs.

What are some of the steps the company will be taking over the next 12 months to improve efficiencies?

Mr. Hawley:
We will continue our program to update distribution centers with The Broadway–Southern California scheduled for a two and a half year renovation beginning this year. During 1988 we renovated four service facilities and implemented productivity based wage incentive programs at Emporium Capwell and Weinstock's. Productivity improved by more than 40 percent in these two locations and our analysis predicts similar improvements for The Broadway.

We also installed an automated on-line interactive transportation system during the past year. This computerized tracking system allows us to monitor all freight routings from the vendor to the consolidator to our distribution center and has resulted in a significant reduction in transportation costs while improving the delivery service to our stores.

In the area of transportation and supply purchasing, we have developed a corporate procurement program to purchase supply commodities and services on a corporate-wide instead of divisional basis. As a result, we have reduced the number of suppliers used by the company and begun to enjoy significant savings from economies of scale.

And in the area of credit, we consolidated the payment processing, billing, and statement mailing activities in one location to further reduce our expense in this area.

What are the company's plans for new stores?

Mr. Burnside:
We just opened an exciting Thalhimers store in Charlotte, North Carolina, which was our most successful opening to date. Later this year we will begin construction on The Broadway–Southern California store in Santa Barbara, a new market with tremendous potential. While our primary strategy is to accelerate modernization in existing stores, we will take advantage of key opportunities as they present themselves. Currently, we are in discussions that could lead to several more new stores over the next three to four years.

Let's turn to the financials. As is typical of a restructured company, Carter Hawley Hale has a relatively large amount of debt. How is the company doing on its debt reduction program?

Mr. Hawley:
We reduced our debt levels by more than $50 million during the past year, which was significantly more than our operating plan called for, and we are working on programs which will further reduce the debt levels of the company.

It is important to note that the financial structure we have in place gives us substantial free cash flow over and above our interest payments. In addition, scheduled principal repayments over the next seven to eight years are quite small in relation to the cash flow currently being generated, and we have a substantial amount of cash flow available for capital expenditures and store modernization.

Could you give us a little more information on the real estate financing done as part of the restructuring?

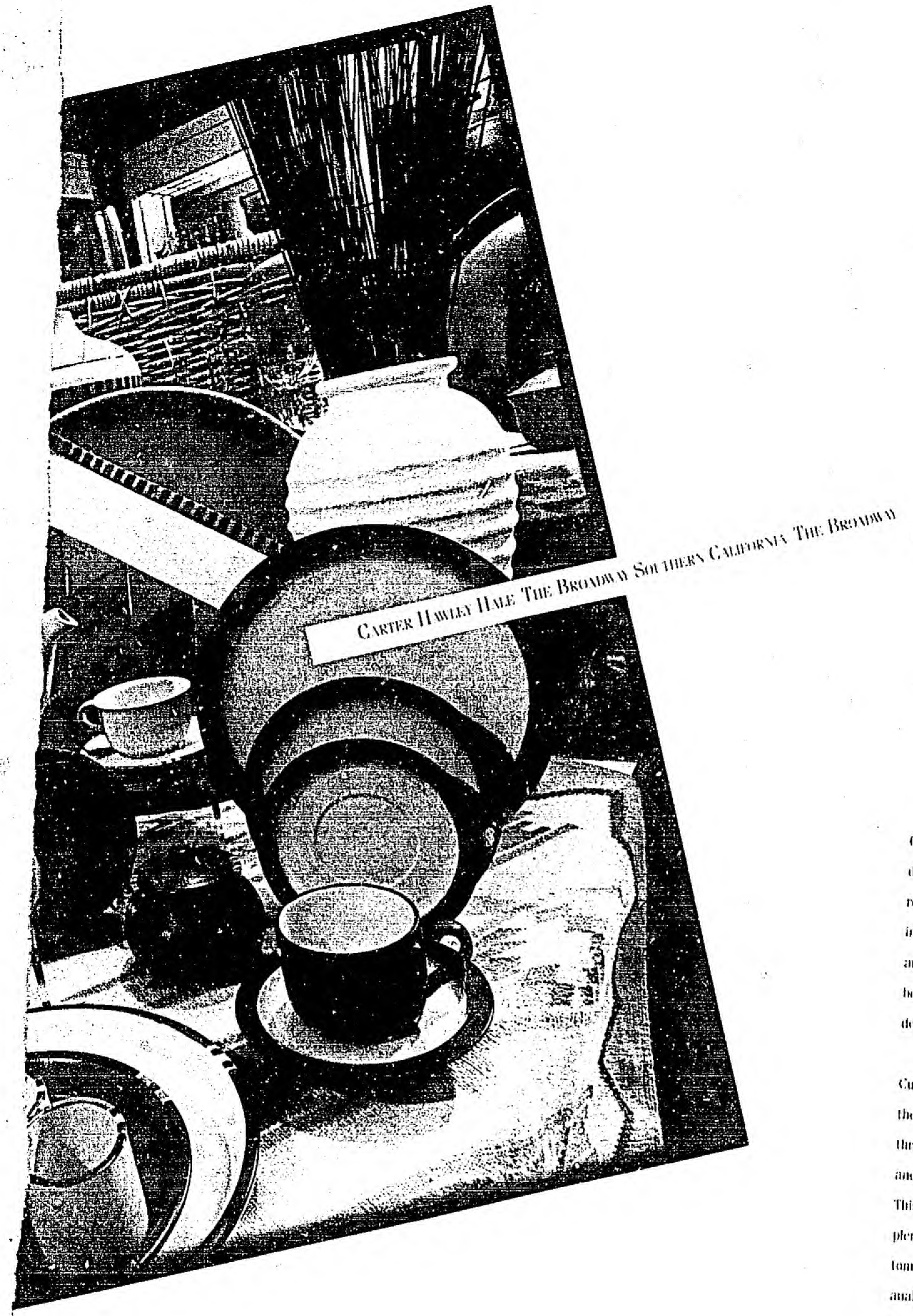
Mr. Hawley:
During the past year we successfully purchased a number of stores which were under lease to the company. In many instances we've had the opportunity to finance these stores on favorable terms, providing the company with sources of long term funds at attractive rates.

Carter Hawley Hale has one of the highest levels of employee ownership of any company traded on the New York Stock Exchange. How has this changed the company and what will it mean in the future?

Mr. Hawley:
Our employee ownership base has linked shareholder interests with employee interests in the best possible manner. All of us have a vested stake in creating value for our shareholders because we are shareholders.

Management and the employees in Carter Hawley Hale's Profit Sharing Plan control more than 55 percent of the company's stock on a fully diluted basis. This stable ownership base helps us attract talent from outside the company and serves as a strong incentive to succeed. Our employee ownership has generated an entrepreneurial spirit in the company that will grow in importance and serve all of our shareholders well in the years ahead.

Carter Hawley Hale



One of the important decisions in a store remodeling project involves space allocation and the atmosphere to be created for individual departments.

Customers influence these spacing decisions through their current and expected purchases. This information is supplemented by direct customer interviews and analysis of overall consumer and demographic trends. The result is an appealing, exciting environment that draws the customer into the department.

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Management's Discussion and Analysis of Results of Operations and Financial Condition

Results of Operations

Overview

The table below highlights sales and earnings from continuing operations before interest and income taxes (EBIT), before one-time special items and excluding John Wanamaker. Management believes it is helpful to examine the Company on this basis in order to fully understand the improved EBIT trend.

	Fifty-two Weeks Ended			
	July 30, 1988	August 1, 1987	January 31, 1987	February 1, 1986
Sales	$2,617.1	$2,626.8	$2,562.7	$2,439.1
EBIT	149.6	130.9	131.5	110.4
Percentage of sales	5.7	5.0	5.1	4.5
EBIT, including John Wanamaker	149.6	139.5	141.6	106.4

A more detailed discussion of results of operations which compares the fiscal year ended July 30, 1988 with the fiscal year ended August 1, 1987 and compares the fiscal year ended January 31, 1987 with the fiscal year ended February 1, 1986 is provided below.

July 30, 1988 and August 1, 1987

Sales were $2,617.1 million in the fifty-two weeks ended July 30, 1988, compared with $2,869.2 in the prior year. Excluding John Wanamaker and two Broadway–Southwest stores, which were sold, sales increased .7 percent in 1988. On a comparative store basis, sales increased .2 percent.

EBIT was $151.1 million in the fifty-two weeks ended July 30, 1988 compared with a loss of $96.7 million in 1987.

A number of one-time special items affected EBIT during the past two years. In order to better understand the EBIT improvement in 1988, it is helpful to examine EBIT before the one-time special items. On this basis EBIT improved 7.2 percent in 1988 to $149.6 million, or 5.7% of sales, compared with $139.5 million, or 4.9% of sales in 1987. EBIT before special items in 1988 excludes a $30.0 million gain on the sale of a shopping center interest and a $28.5 million charge for operational and facility realignment programs. EBIT before special items in 1987 excludes one-time charges for fees and expenses directly related to the Restructuring of approximately $40.7 million, nonrecurring costs resulting from the Restructuring of $34.9 million, costs associated with the change in fiscal year of approximately $42.0 million (consisting of an $11.8 million LIFO charge related to accelerated inventory markdowns and $30.2 million of deferred buying and occupancy costs which, if the Company had not changed its fiscal year, would have been allocated to the fourth quarter of fiscal 1987), and $112.4 million of charges relating to operations, of which approximately $65.0 million resulted from accelerated inventory markdowns. EBIT before special items for 1987 also excludes a loss of $6.2 million on the sale of John Wanamaker.

The table below reflects how the Restructuring costs were classified in the Consolidated Statement of Earnings for the fifty-two weeks ended August 1, 1987:

	Cost of Goods Sold	Selling, General, and Administrative Expenses	Operational and Facility Realignment Program Costs	Direct Restructuring Costs	Other Restructuring Costs	Total
Fees and expenses				$40.7		$ 40.7
Nonrecurring restructuring costs		$11.8	$15.7		$7.4	34.9
Change in fiscal year	$ 42.0					42.0
Operating charges	65.0	47.4				112.4
	$107.0	$59.2	$15.7	$40.7	$7.4	$230.0

Excluding the above Restructuring expenses in 1987, cost of goods sold was 71.8 percent of sales in 1988 compared with 71.7 percent in 1987. The slight increase in 1988 was primarily due to higher markdowns and an increase in the LIFO provision. This increase was partially offset by lower inventory shortage and increased sales of private label merchandise. Selling, general, and administrative expenses were 22.5 percent of sales in 1988 compared with 23.5 percent in 1987.

Interest expense as a percent of sales was 5.2 percent in 1988 compared with 2.3 percent in 1987. The increase is primarily due to increased borrowing associated with the Restructuring and to increased rates. The effect of the increase is partially offset by elimination of the $30.0 million annual preferred dividend requirement. Additionally, proceeds from the sale of John Wanamaker were used to reduce debt in 1987.

The effective income tax rate was 40.0 percent in 1988 versus a benefit of 29.7 percent in 1987. The lower benefit rate in 1987 was primarily due to the taxable gain on the sale of John Wanamaker and the nondeductibility of certain costs relating to the Restructuring.

Other items affecting net earnings include after tax charges of $1.7 million in 1988 and $29.3 million in 1987 relating to the early retirement of debt, an after tax credit of $10.1 million in 1988 resulting from a change in financial accounting for the capitalization of inventory costs, and an after tax loss of $34.1 million in 1987 from discontinued operations.

January 31, 1987 and February 1, 1986

Sales increased 3.7 percent in the fifty-two weeks ended January 31, 1987 to $2,996.0 million compared with $2,890.0 million in the prior year. On a comparative store basis, sales increased 2.2 percent.

EBIT was $114.4 million in the fifty-two weeks ended January 31, 1987 compared with $106.4 million in the prior year. Excluding the special charges relating to the Restructuring of $25.0 million and the loss on the sale of John Wanamaker of $2.2 million, EBIT was $141.6 million in 1986, an increase of 33.0 percent over EBIT of $106.4 million in the prior year.

Cost of goods sold improved to 72.4 percent of sales in 1986 from 73.5 percent in 1985, primarily due to lower markdowns, lower inventory shortage, and increased sales of private label merchandise. This improvement was partially offset by a $5.5 million decrease in the LIFO credit. Selling, general, and administrative expenses were 22.9 percent of sales in 1986 and 1985.

Lower average borrowings and rates decreased interest expense both as a percent of sales and in actual dollars in 1986 versus 1985. Interest expense was 2.8 percent of sales in 1986 compared with 3.2 percent in 1985.

The effective income tax rate was 84.0 percent in 1986 compared with a benefit of 19.7 percent in 1985. The higher rate in 1986 was primarily due to the taxable gain on the sale of John Wanamaker, the nondeductibility of costs relating to the Restructuring, higher state taxes, and the reduction of investment tax credits under the new tax law.

Other items affecting net earnings were after tax earnings of $42.6 million in 1986 and $29.8 million in 1985 from discontinued operations, an after tax charge of $29.3 million in 1986 as a result of costs relating to early retirement of debt, and an after tax charge of $14.1 million in 1986 as a result of a change in accounting for computer software development costs.

Inflation

The effect of inflation on the Company's sales gains is, in management's opinion, most closely approximated by the Department Store Inventory Price Index published by the Bureau of Labor Statistics. This index increased 3.3 percent in the fifty-two weeks ended July 30, 1988, 1.3 percent in the twenty-six weeks ended August 1, 1987, 1.2 percent in 1986, 2.0 percent in 1985.

Financial Condition

As a result of the Restructuring, the existing credit facilities were cancelled and were replaced by the following facilities during 1988.

Up to $650.0 million was available to the Company under a five-year working capital and letter of credit facility (the Facility) bearing interest at variable rates. The Facility places certain restrictions on the level of funds available and is reduced by $40.0 million annually beginning December 31, 1988. At July 30, 1988, $375.0 million, of which approximately $350.0 million was collateralized by customer accounts receivable, was borrowed under the Facility. Subsequent to year end, the Company chose to amend the Facility to mature on August 4, 1989 in anticipation of a restructuring of the related debt.

During 1988, the Company arranged $832.2 million in long-term financings. These financings included $125.0 million of 12 1/4 percent Senior Subordinated Notes due 1996; $225.0 million of 12 1/2 percent Senior Subordinated Debentures due 2002; $347.2 million under a long-term real estate facility due 1997; and $135.0 million under a long-term real estate facility due 1995, of which $86.2 million has been financed at July 30, 1988. The remaining $48.8 million of this facility will be funded in the future to replace existing long-term debt. The subordinated debt agreements restrict the payment of cash dividends unless the consolidated net worth of the Company exceeds $600.0 million.

The table below compares debt outstanding at July 30, 1988 with proforma debt outstanding at August 1, 1987, assuming the August 27, 1987 Restructuring was completed, and with debt outstanding at August 1, 1987.

	July 30, 1988	August 1, 1987	
	Actual	Proforma	Actual
Current installments	$ 4.4	$ 5.5	$ 7.3
Long-term debt	1,177.2	1,205.0	769.8
Capital lease obligations	83.2	105.8	112.0
	$1,264.8	$1,316.3	$889.1

Capital expenditures are financed through a combination of internally generated funds from operations, property financings, and other borrowings. Capital expenditures for new store space, store modernization, and support facilities and equipment were $55.3 million in 1988, $15.0 million in 1987, $89.6 million in 1986 and $94.0 million in 1985. The Company opened a new department store at the beginning of fiscal 1989. No new department stores were opened in 1988 or 1987, and four department stores were opened during 1986. During 1988, the Company completed the renovation of fourteen stores. Another eight to ten stores are scheduled for renovation during 1989. The Company also spent $24.9 million for the acquisition of certain properties previously operated under capital or operating leases. These properties were subsequently pledged as collateral for the real estate financings completed in 1988.

Consolidated Statement of Earnings

(In thousands, except per share data)	Year Ended July 30, 1988	Year Ended August 1, 1987	Twenty-six Week Period Ended August 1, 1987	Year Ended January 31, 1987	Year Ended February 1, 1986
		(unaudited)			
Sales	$2,617,143	$2,869,205	$1,164,338	$2,995,977	$2,889,950
Cost of goods sold, including occupancy and buying costs	1,879,664	2,163,005	919,764	2,168,653	2,123,185
Selling, general, and administrative expenses	587,869	732,863	349,185	685,680	660,346
Gain on sale of shopping center interest	30,000				
Costs of operational and facility realignment programs	28,500	15,700	15,700		
Loss on sale of John Wanamaker		6,200	4,000	2,200	
Direct costs relating to restructuring program		40,750	15,750	25,000	
Other restructuring costs		7,400	7,400		
Earnings (loss) from continuing operations before interest expense and income taxes	151,110	(96,713)	(147,461)	114,444	106,419
Interest expense	135,600	67,370	28,134	82,915	91,203
Pretax earnings (loss) from continuing operations	15,510	(164,083)	(175,595)	31,529	15,216
Income taxes	6,200	(48,800)	(68,300)	26,500	(3,000)
Earnings (loss) from continuing operations	9,310	(115,283)	(107,295)	5,029	18,216
Discontinued operations, net of income taxes of $(28,350), $(56,800), $38,900, and $25,100		(34,115)	(63,578)	42,586	29,809
Earnings (loss) before extraordinary item and cumulative effect of changes in accounting	9,310	(149,398)	(170,873)	47,615	48,025
Extraordinary costs relating to early retirements of debt, net of income tax benefits of $1,210 and $28,804	(1,750)	(29,253)		(29,253)	
Cumulative effect of changes in accounting					
Capitalization of inventory costs, net of income tax expense of $10,440	10,100				
Expensing of computer software development costs, net of income tax benefit of $15,505				(14,148)	
Net earnings (loss)	$ 17,660	$ (178,651)	$ (170,873)	$ 4,214	$ 48,025
Primary earnings (loss) per common share					
Continuing operations	$ .33	$ (7.24)	$ (6.06)	$ (1.23)	$ (.60)
Discontinued operations		(1.70)	(3.15)	2.10	1.52
Extraordinary costs related to early retirements of debt	(.08)	(1.46)		(1.44)	
Changes in accounting					
Capitalization of inventory costs	.47				
Expensing of computer software development costs				(.70)	
	$ .72	$ (10.40)	$ (9.21)	$ (1.27)	$ .92

See accompanying Summary of Significant Accounting Policies and Financial Review.

Consolidated Balance Sheet

(In thousands)	July 30, 1988	August 1, 1987
Assets		
Current assets		
Cash	$ 24,643	$ 14,885
Accounts receivable, net	473,826	546,819
Merchandise inventories	536,656	432,866
Deferred income taxes	11,825	12,513
Other current assets	27,833	28,847
	1,074,783	1,035,930
Property and equipment, net	535,661	502,083
Other assets	61,178	33,635
Net assets of the specialty store divisions		350,438
	$1,671,622	$1,922,086
Liabilities and Shareholders' Equity		
Current liabilities		
Current installments	$ 4,364	$ 7,342
Accounts payable	306,846	219,721
Accrued liabilities	177,648	224,624
Current income taxes	12,867	12,119
	501,725	463,806
Long-term debt	1,177,248	769,820
Capital lease obligations	83,168	112,042
Other liabilities	62,042	42,217
Long-term deferred income taxes	77,630	88,429
Redeemable preferred stock		300,000
Common stock, $.01 par value ($5 par value at August 1, 1987)	226	101,837
Other paid-in capital	581,349	174,404
Accumulated deficit	(811,766)	(130,469)
	$1,671,622	$1,922,086

See accompanying Summary of Significant Accounting Policies and Financial Review.

Consolidated Statement of Cash Flows

(In thousands)	Year Ended July 30, 1988	Year Ended August 1, 1987	Twenty-six Week Period Ended August 1, 1987	Year Ended January 31, 1987	Year Ended February 1, 1986
Operating activities		(unaudited)			
Earnings (loss) from continuing operations	$ 9,310	$(115,283)	$(107,295)	$ 5,029	$ 18,216
Depreciation and amortization	51,829	57,851	24,311	55,285	54,154
Gain on sale of shopping center interest	(30,000)				
Deferred income taxes	(22,900)	(14,664)	(48,602)	26,320	(2,974)
Loss, net of income taxes, on sale of John Wanamaker		6,700		6,700	
Change in operating assets and liabilities					
Accounts receivable, net	72,993	(111,893)	(26,123)	21,715	22,028
Merchandise inventories	(103,790)	116,451	65,058	52,315	(52,740)
Accounts payable and accrued liabilities	40,149	150,250	80,305	(48,091)	70,796
Other, net	8,279	(19,049)	(5,361)	(24,831)	(12,841)
Net cash provided (used) by					
Continuing operations	25,870	70,363	(17,707)	94,442	96,639
Discontinued operations		(72,660)	69,077	(131,464)	62,192
	25,870	(2,297)	51,370	(37,022)	158,831
Investment activities					
Store property and equipment purchased	(80,205)	(65,841)	(15,034)	(89,647)	(94,029)
Properties sold and retired	2,199	27,487	25,732	6,839	1,915
Sale of shopping center interest	32,000				
Elimination of John Wanamaker properties		80,243		80,243	
Change in investment in specialty store divisions		(37,620)	(196,867)	212,588	(69,257)
Net cash provided (used) by investment activities	(46,006)	4,269	(186,169)	210,023	(161,371)
Financing activities					
Increase (decrease) in notes payable	(537,000)	447,500	8,000	529,000	(83,179)
Issuances of long-term debt	1,162,929				250,000
Early retirement of long-term debt		(400,000)		(400,000)	
Costs relating to early retirements of long-term debt, net of items not requiring cash outlay	(1,750)	(23,173)		(23,173)	
Other retirements of long-term debt and capital lease obligations	(250,353)	(179,268)	(63,437)	(214,303)	(54,657)
Net change in debt allocated to the specialty store divisions		175,392	199,639	(26,931)	(72,945)
Issuances of common stock	4,587	22,859	13,593	14,894	12,062
Restructuring dividend of $17 per share	(346,464)				
Common and preferred stock dividends	(2,055)	(48,375)	(21,155)	(54,255)	(53,638)
Net cash provided (used) by financing activities	29,894	(5,065)	136,640	(174,768)	(2,357)
Net increase (decrease) in cash	9,758	(3,093)	1,841	(1,767)	(4,897)
Cash at the beginning of the period	14,885	17,978	13,044	14,811	19,708
Cash at the end of the period	$ 24,643	$ 14,885	$ 14,885	$ 13,044	$ 14,811

See accompanying Summary of Significant Accounting Policies and Financial Review.

Consolidated Statement of Common Stock and Other Shareholders' Equity

(in thousands)	Common Stock Shares	Common Stock Par Value	Other Paid-In Capital	Accumulated Earnings
Balance, February 2, 1985	19,067	$ 95,334	$140,358	$ 112,474
Net earnings				48,025
Cash dividends				
Common stock ($1.22 per share)				(23,638)
Redeemable preferred stock				(30,000)
Issuance of common stock under Employee Stock Ownership Benefit Plan	92	459	2,154	
Issuance of common stock under Dividend Reinvestment and Stock Purchase Plan	118	592	2,522	
Exercise of stock options	282	1,412	4,923	
Reversal of foreign currency translation adjustment				4,739
Balance, February 1, 1986	19,559	97,797	149,957	111,600
Net earnings				4,214
Cash dividends				
Common Stock ($1.22 per share)				(24,255)
Redeemable preferred stock				(30,000)
Issuance of common stock under Employee Stock Ownership Benefit Plan	67	337	2,057	
Issuance of common stock under Dividend Reinvestment and Stock Purchase Plan	97	485	3,040	
Issuance of common stock to Profit Sharing Plan	10	50	303	
Exercise of stock options	296	1,479	6,602	
Conversion of convertible debentures	13	65	476	
Balance, January 31, 1987	20,042	100,213	162,435	61,559
Net loss				(170,873)
Cash dividends				
Common stock ($.305 per share)				(6,155)
Redeemable preferred stock				(15,000)
Issuance of common stock under Dividend Reinvestment and Stock Purchase Plan	31	152	1,546	
Exercise of stock options	147	738	5,062	
Conversion of convertible debentures	147	734	5,361	
Balance, August 1, 1987	20,367	101,837	174,404	(130,469)
Net earnings				1[illegible]560
Cash dividends on redeemable preferred stock				([illegible],055)
Restructuring dividend of $17 per share				(346,464)
Change in common stock par value		(101,633)	101,633	
Conversion of redeemable preferred stock to common and preferred stock of The Neiman-Marcus Group			298,987	
Distribution of net assets of The Neiman-Marcus Group				(350,438)
Issuance of common stock under the 1987 Stock Incentive Plan	1,827	18	24,620	
Stock Incentive Plan contra*			(22,869)	
Exercise of stock options and other stock conversions	398	4	4,574	
Balance, July 30, 1988	22,592	$ 226	$581,349	$(811,766)

*Other Paid-in Capital is net of notes receivable and unamortized costs relating to the 1987 Stock Incentive Plan (see Employee Stock Incentive Plan footnote in the Financial Review).

See accompanying Summary of Significant Accounting Policies and Financial Review.

Summary of Significant Accounting Policies

The Restructuring
On August 26, 1987, the Company's shareholders approved a plan of restructuring (the Restructuring) in which the Company was reorganized into two separate companies. The operations of the Company's specialty store divisions comprising Bergdorf Goodman, Contempo Casuals and Neiman-Marcus were transferred to The Neiman-Marcus Group a newly formed Delaware corporation. The Company continues to operate the department store divisions comprising The Broadway–Southern California, The Broadway–Southwest, Emporium Capwell, Thalhimers, and Weinstock's.

All public common shareholders of the Company, including participants in the Company's profit sharing plan, retained their stock in the Company and also received $17 in cash and a share of stock in The Neiman-Marcus Group for each Company share held. The convertible preferred shares of the Company (held by General Cinema Corporation) were exchanged for shares in The Neiman-Marcus Group. General Cinema received no cash or shares of the Company in respect of its preferred shares. Senior Management of the Company received no cash or shares of The Neiman-Marcus Group in respect of their existing holdings, except for the shares held in the profit sharing plan, but, rather, additional common shares of the Company. The Restructuring allowed certain shareholders, including participants in the profit sharing plan, to make elections as to what cash or securities they would hold after the effective time of the Restructuring and incorporated a market formula designed to provide all shareholders with essentially equivalent value.

Total direct costs related to the Restructuring amounted to $93.2 million of which $15.7 million was expensed in the twenty-six week period ended August 1, 1987 and $25.0 million was expensed in the fifty-two week period ended January 31, 1987. In addition, $8.3 million was expensed by The Neiman-Marcus Group in the twenty-six week period ended August 1, 1987. The remaining $44.2 million comprises debt issuance costs which have been capitalized and are being amortized over the life of the new debt. In addition, $51.6 million of other restructuring costs relating primarily to certain shared costs and costs of operational and facility realignment programs have been incurred, of which $28.5 million was expensed in the fifty-two week period ended July 30, 1988 and $23.1 million was expensed in the twenty-six week period ended August 1, 1987. The operational and facility realignment programs include the consolidation of certain nonselling operating activities, the conversion of certain merchandise departments from owned to leased operations, and other programs designed to reduce operating costs and improve efficiency.

Basis of Reporting
The Consolidated Financial Statements include the accounts of the Company and its subsidiaries. All significant intercompany transactions and accounts have been eliminated in consolidation.

Discontinued operations include the specialty store divisions transferred to The Neiman-Marcus Group and Holt Renfrew, a specialty store subsidiary sold effective February 1, 1986. The John Wanamaker department store subsidiary, which was sold effective December 31, 1986, is included in continuing operations.

Fiscal Year
In 1987, the Company changed its fiscal year end from the Saturday closest to January 31 to the Saturday closest to July 31. The change was made to enhance the comparability of the Company's financial statements issued subsequent to August 1, 1987. Fiscal 1988 comprised the 52 weeks ended July 30, 1988, fiscal 1987 comprised the 26 weeks ended August 1, 1987, and fiscal 1986 and 1985 comprised the 52 weeks ended January 31, 1987 and February 1, 1986.

Unaudited Statements

In the opinion of the Company's management the unaudited Consolidated Statements of Earnings and Cash Flows for the fifty-two week period ended August 1, 1987 contain all adjustments, including normal recurring adjustments and the extraordinary charge for costs relating to early retirement of debt, necessary for the amounts shown to be fairly stated. Due to the seasonal nature of the retail business wherein a significant portion of sales for the year are incurred in the Christmas season, the Company follows the practice of allocating certain fixed buying and occupancy costs within the Company's fiscal year in order to match these expenses with the resulting sales revenue. Earnings from continuing operations for the twenty-six week period ended August 1, 1987 included $30.2 million of such buying and occupancy costs which, except for the change in the Company's year end, would have been deferred to the fourth quarter of 1987.

Financial data for the 52 weeks ended August 1, 1987 and January 31, 1987 each include operating data for the 26 week period ended January 31, 1987. Sales and net loss for this 26 week period were $1,704.9 million and $7.8 million.

Changes in Accounting Policies

During 1988, the Company adopted Statement of Financial Accounting Standards No. 94 "Consolidation of All Majority-owned Subsidiaries" which requires the consolidation of all majority-owned subsidiaries for all periods presented. As a result, the assets and liabilities of the finance subsidiaries have been reported on a consolidated basis in the Consolidated Balance Sheet. Previously they had been reported on an equity basis. There was no effect on the reporting of earnings since the pretax earnings of the finance subsidiaries, before noninterest items, had been reported as a reduction of interest expense in prior years.

In 1988, the Company changed its method of inventory cost capitalization to conform to the uniform cost capitalization rules provided under the Tax Reform Act of 1986. The change results in the capitalization of certain inventory storage and processing costs to better match these costs with related sales. The change had no material effect on 1988 earnings from continuing operations. The cumulative effect of the change on prior years was a gain of $10.1 million, net of income taxes of $10.4 million, which was reflected in net earnings in the first quarter of 1988.

In 1988 the Company adopted Statement of Financial Accounting Standards No. 95 "Statement of Cash Flows" which requires cash flows to be classified into operating, investing, or financing activities. Previously, the Company had presented a Statement of Changes in Financial Position. Prior year data for all periods presented has been restated.

In 1986, the Company changed its method of accounting for costs incurred in the development of major computer software applications for internal use from capitalizing and amortizing to expensing these costs as incurred. This change was made to conform the Company's accounting policy with predominant practice. The change, which was adopted retroactive to February 2, 1986, had no material effect on 1986 earnings from continuing operations. The cumulative effect of the change on prior years was a charge of $14.1 million, net of income taxes of $15.5 million, and was reflected in net earnings for the first quarter of 1986.

In 1986, the Company also adopted Statement of Financial Accounting Standards No. 87 "Employers' Accounting for Pensions" (FAS No. 87) for all defined benefit pension plans. The change, which was adopted retroactive to February 2, 1986, had no material effect on 1986 earnings from continuing operations. The provisions of the Statement requiring recognition, beginning in fiscal 1990, of a pension asset and a liability for any unfunded accumulated benefit obligation have not been adopted. Restatement of prior years pension expense was not permitted.

Sales
Sales are net of returns, exclude sales tax, and comprise merchandise, services, and sales by leased departments.

Customer Accounts Receivable
An account is generally written off when the aggregate of payments made in the most recent six months is less than one full monthly scheduled payment or if it is otherwise determined that the account is uncollectible.

Inventories
Merchandise inventories are valued at cost, which is less than market, as determined by the retail method on the last-in, first-out (LIFO) basis.

Property and Equipment
Property and equipment are recorded at cost and include major renewals and improvements of a permanent nature. Other renewals and improvements and maintenance and repairs are expensed.

Depreciation and Amortization
Depreciation and amortization are provided on the straight-line method over the estimated useful lives of the property and equipment, or over the terms of the related leases, if shorter.

Store Preopening
Store opening and preopening costs are charged to selling, general, and administrative expenses during the year of the store opening.

Income Taxes
Income taxes are provided currently for all items included in the Consolidated Statement of Earnings regardless of when such taxes are payable. Deferred taxes arise primarily from the recognition of revenues and expenses for book and tax purposes in different periods.

Earnings Per Share of Common Stock
Primary earnings per share are computed on the basis of the weighted average number of shares outstanding during the year, including dilutive stock options, net of shares deemed repurchased in connection with the Company's 1987 Stock Incentive Plan, and after deduction of preferred dividend requirements. The average shares used were 21.8 million in 1988, 20.2 million in 1987 and 1986, and 19.6 million in 1985.

As part of the Restructuring the Company's redeemable preferred stock was converted and exchanged for shares of The Neiman-Marcus Group on August 27, 1987. On a supplementary basis, assuming the conversion of the redeemable preferred stock at the beginning of the current year and elimination of the related preferred dividend requirement, 1988 earnings per share from operations would be $.42 and net earnings per share would be $.81.

The calculation of fully diluted earnings per common share had no dilutive effect and is not disclosed.

Financial Review

Discontinued Operations

As a result of the Restructuring, the assets and liabilities of the Company's specialty store divisions were transferred to The Neiman-Marcus Group in August 1987. Net assets of the specialty store divisions of $350.4 million at August 1, 1987 comprised net current assets of $221.4 million and net long-term assets of $129.0 million. Specialty store sales for the twenty-six weeks ended August 1, 1987 were $517.9 million, and were $1,093.8 million in 1986, and $1,005.6 million in 1985. Effective February 1, 1986, the Company sold its Holt Renfrew specialty store subsidiary for $29.7 million in cash, resulting in a loss of $2.5 million. Holt Renfrew's sales were $82.4 million in 1985.

Sale of John Wanamaker

On December 31, 1986, the Company completed the sale of its John Wanamaker subsidiary for approximately $183.0 million in cash. The $2.2 million pretax loss on the sale recorded in 1986 was based upon management's determination of book value. Such determination was subject to acceptance by the purchaser. During 1987, the parties agreed to an adjustment to the original purchase price which resulted in a pretax charge of $8.0 million, shared equally by the Company and The Neiman-Marcus Group. John Wanamaker's sales were $433.2 million in the eleven months ended December 31, 1986, and $450.8 million in 1985.

Interest Expense

Interest expense increased due to higher average borrowings resulting from the Restructuring and to increased rates. The components of net interest expense are as follows:

(In millions)	1988	1987	1986	1985
Interest on long-term debt	$ 89.1	$17.4	$92.7	$91.9
Imputed interest on capitalized lease obligations	8.3	5.4	11.8	12.3
Interest on short-term debt	34.2	19.1	10.9	18.8
Discount on customer receivables sold to banks			6.1	13.8
Capitalized interest	(1.0)	(.3)	(2.1)	(4.8)
Interest expense attributable to discontinued operations		(14.4)	(36.1)	(40.0)
Amortization of debt issuance costs	5.6			
Other	(.6)	.9	(.4)	(.8)
Interest expense	$135.6	$28.1	$82.9	$91.2

Accrued interest totaling $26.8 million at July 30, 1988 and $3.9 million at August 1, 1987 is reflected in accrued liabilities. Interest payments net of amounts capitalized, and excluding payments on debt allocated to the specialty store divisions, were $112.2 million in 1988, $28.1 million in 1987, $92.5 million in 1986 and $90.5 million in 1985.

Income Tax Expense

The provision for income taxes consists of:

(In millions)	1988	1987	1986	1985
Current				
Federal	$22.4	$(14.5)	$ (3.2)	$(2.1)
State	6.7	(5.2)	3.4	2.1
	29.1	(19.7)	.2	—
Deferred				
Federal	(19.0)	(42.7)	24.0	(1.8)
State	(3.9)	(5.9)	2.3	(1.2)
	(22.9)	(48.6)	26.3	(3.0)
Income tax expense (benefit)	$ 6.2	$(68.3)	$26.5	$(3.0)

Deferred income tax expense (benefit) results from timing differences in the recognition of revenue and expense for tax and financial statement purposes. The sources of these differences and their tax effects were:

(In millions)	1988	1987	1986	1985
State income taxes	$ (1.6)	$ 2.5	$ 1.6	$ 1.8
Book-tax depreciation differential	(.6)	2.2	3.0	6.2
Finance charge income	.1	(.5)	(.5)	2.5
Deferred revenue	1.2			
Capitalized interest and other real estate costs	1.0	.2	1.7	1.0
Deferred gross profit on installment sales	(16.3)	(12.7)	16.4	(4.5)
Prepaid and deferred charges	(3.3)	(7.4)	.2	(3.8)
Inventory adjustments	.6	(12.0)	1.8	.6
Operational and facility realignment programs	(4.4)	(9.0)		
Restructuring reserves	1.3	(4.1)		
Charitable contribution carryover		(1.2)	(.3)	(2.7)
Deferred compensation	.4	(.9)	.5	(3.0)
Other, net	(1.3)	(5.7)	1.9	(1.1)
Deferred income tax expense (benefit)	$(22.9)	$(48.6)	$26.3	$(3.0)

Income taxes as a percent of earnings before income taxes differed from the statutory federal income tax rate as set forth below:

	In Millions				Percent of Pre-tax Earnings			
	1988	1987	1986	1985	1988	1987	1986	1985
Federal income tax at statutory rate	$5.3	$(79.0)	$14.5	$ 7.0	34.0%	(45.0)%	46.0%	46.0%
Book-tax rate differential		7.2				4.1		
Restructuring costs		7.1	11.5			4.0	36.5	
State income taxes	1.8	(6.1)	2.7	.4	11.9	(3.5)	8.5	2.8
John Wanamaker basis difference			5.6				17.7	
Net investment and other tax credits	(.7)	1.2	(2.6)	(7.0)	(4.5)	.7	(8.2)	(46.7)
Charitable contribution			(2.0)	(1.8)			(6.3)	(11.7)
ESOB Plan credit			(1.1)	(1.1)			(3.5)	(7.2)
Reversal of taxes previously provided			(1.6)				(5.1)	
Other, net	(.2)	1.3	(.5)	(.5)	(1.4)	.8	(1.6)	(2.9)
Income taxes	$6.2	$(68.3)	$26.5	$(3.0)	40.0%	(38.9)%	84.0%	(19.7)%

The book-tax rate differential in 1987 arises as the Company has different fiscal year ends for financial reporting and tax return purposes.

The Financial Accounting Standards Board issued Statement No. 96 "Accounting for Income Taxes" in December 1987. The statement follows the liability method of accounting for income taxes and requires the adjustment of previously recorded deferred tax liabilities and assets for the effects of changes in tax laws or rates through the date of the latest financial statements presented. Early adoption of the Statement is expected in the fiscal year ending July 29, 1989 and will result in an increase to shareholders' equity of approximately $15.0 million.

In connection with the Restructuring, the Company and The Neiman-Marcus Group entered into a Tax Allocation Agreement which provides for the payment and filing of tax returns for The Neiman-Marcus Group for periods up to and including August 1, 1987. The Company will be responsible for the payment of the taxes of the specialty store business for the taxable periods up to and including August 1, 1987 and will be entitled to the refunds for such periods. The Neiman-Marcus Group will be responsible for the payment of certain taxes arising out of transition rules of the Tax Reform Act of 1986 relating to installment sales, bad debt reserves, and inventory capitalization, which are attributable to the specialty store business for periods prior to the Restructuring. Income tax payments, including amounts relating to The Neiman-Marcus Group prior to the Restructuring, were $11.7 million in 1988, $12.4 million in 1987, $10.2 million in 1986 and $19.6 million in 1985.

Accounts Receivable and Credit Operations

Accounts receivable at year end were as follows:

(In millions)	1988	1987
Customer receivables	$436.9	$401.9
Other receivables		
Income taxes	12.2	27.8
The Neiman-Marcus Group	21.3	54.7
Sale of Denver stores		46.2
Other	9.9	22.3
	480.3	552.9
Less allowance for doubtful accounts	6.5	6.1
Accounts receivable, net	$473.8	$546.8

The receivable from The Neiman-Marcus Group includes $11.8 million receivable under the Tax Allocation Agreement and $9.5 million receivable for shared costs and other reimbursable expenses incurred by the Company. Fees received from The Neiman-Marcus Group in connection with Information Services support are treated as a reduction of selling, general, and administrative expenses.

Selected credit operations information is as follows:

(Dollar amounts in millions)	1988	1987	1986	1985
Credit sales as a percent of gross sales	53.2%	52.0%	53.8%	56.7%
Uncollectible account losses, net of recoveries, as a percent of credit sales	1.2%	1.9%	1.6%	1.5%
Finance charge income	$65.4	$33.3	$81.7	$99.2

Finance charge income is treated as a reduction of selling, general, and administrative expenses.

Inventories

Merchandise inventories were $536.7 million at July 30, 1988 and $432.9 million at August 1, 1987. In 1988, the LIFO adjustment to cost of sales was a charge of $4.8 million compared with a charge of $11.8 million in 1987. In 1986 and 1985, the LIFO adjustment to cost of sales were credits of $.7 million and $6.2 million. If all inventories had been valued on the first-in, first-out (FIFO) basis, they would have been higher by $52.4 million at July 30, 1988, $45.6 million at August 1, 1987, $33.8 million at January 31, 1987, and $38.4 million at February 1, 1986.

Leases

Certain Company operations are conducted in leased properties, which include retail stores, distribution centers, offices, and other facilities. Leases are generally for periods of up to thirty years, with renewal options for substantial periods. Leases are generally at fixed rentals, except that certain leases provide for additional rentals based on [illegible]s in excess of predetermined levels.

Rent expense for each year was as follows:

(In millions)	1988	1987	1986	1985
Minimum rent	$33.1	$16.8	$34.0	$32.3
Rent based on sales	3.8	1.9	4.5	4.8
Total rent expense	$36.9	$18.7	$38.5	$37.1

Future minimum lease payments are as follows:

(In millions)	Capital Leases	Operating Leases
1989	$ 10.7	$ 30.2
1990	10.7	29.8
1991	10.7	29.6
1992	10.3	29.4
1993	10.2	29.3
Thereafter	118.4	517.2
Total future minimum lease obligations	$171.0	$665.5
Present value including $3.2 million current portion of capital lease obligations	$ 86.4	$262.7

Present value of operating leases is determined by discounting future minimum rent commitments, less assumed executory and administrative costs, at rates that approximate the Company's financing costs at the inception of the lease.

Property and Equipment

Property and equipment at year end were as follows:

(In millions)	1988	1987
Land	$ 36.3	$ 37.8
Buildings and improvements	313.4	204.1
Leasehold improvements	84.1	104.8
Fixtures and equipment	425.0	413.2
Construction in progress	38.7	6.2
Leased property under capital leases, primarily buildings	120.1	175.8
	1,017.6	941.9
Less accumulated depreciation and amortization		
Owned property	424.8	354.1
Leased property under capital leases	57.1	85.7
	481.9	439.8
Property and equipment, net	$535.7	$502.1

Property and equipment at July 30, 1988 includes department store assets held for sale with a net carrying value of $17.8 million.

Capital expenditures during the year were as follows:

(Dollar amounts in millions)	1988	1987	1986	1985
New stores	$ 9.9	$ 4.3	$49.8	$61.3
Store modernization	37.3	4.4	24.6	23.7
Support facilities and equipment	8.1	6.3	15.2	9.0
Purchases of leased stores	24.9			
Capital expenditures	$80.2	$15.0	$89.6	$94.0

Expenditures for new stores include acquisition costs of land, buildings and improvements, and related fixtures and equipment. Store modernization expenditures include renovating, expanding, and re-equipping existing stores. Support facilities and equipment expenditures relate to office buildings, distribution centers, and other nonstore outlays. During 1988, certain properties previously operated under capital or operating leases were purchased and subsequently used as collateral for certain long-term debt financings.

Long-Term Debt

Long-term debt at year end was as follows:

(In millions)	1988	1987
Term loan maturing in 1995 (8.5 percent)	$ 86.2	
7½–8¾ percent Notes		$ 21.5
Debt maturing within one year (8.3 percent weighted average interest rate)		712.2
Notes maturing 1989 (9.4 percent weighted average interest rate)	375.0	
9.90 percent Notes due 1989–2010	9.7	25.6
10.69 percent Notes due 1997	347.2	
Other	6.1	6.5
	824.2	765.8
Subordinated debt		
8.95 percent Notes due 1990–1992	3.0	4.0
12¼ percent Notes due 1996	125.0	
12½ percent Debentures due 2002	225.0	
Long-term debt	$1,177.2	$769.8

During 1988, the Company completed $783.4 million of new long-term debt financing. A total of $86.2 million was obtained under a $135.0 million Term Loan Agreement which bears interest at variable rates and matures in 1995. The loans are secured by mortgages on certain Company properties. An additional $347.2 million was obtained under a real estate facility bearing interest at 10.69 percent and requiring monthly principal repayments based on a 300 month amortization table beginning in 1992 with the balance due in 1997. Publicly held subordinated debt provided a further $350.0 million comprising $125.0 million of 12¼ percent Subordinated Notes due 1996 and $225.0 million of 12½ percent Subordinated Debentures due 2002. The Debentures are subject to mandatory redemption of $45.0 million per year beginning in 1998. The Subordinated Debt agreements restrict the payment of cash dividends unless the consolidated net worth of the Company exceeds $600.0 million.

During 1988, the refinancing of debt on certain mortgaged properties resulted in a net of tax charge of $1.7 million. During 1987, the retirement of public debt to facilitate the Restructuring resulted in a net of tax charge of $29.3 million.

At August 1, 1987, $712.2 million of debt maturing within one year was classified as long-term debt to reflect the subsequent refinancing of those borrowings on a long-term basis.

Principal maturities of long-term debt payable over the next five years are $1.2 million, $376.2 million, $1.2 million, $1.2 million, and $1.7 million. Long-term debt includes $449.4 million secured by property with a net carrying value of $213.2 million.

Bank Credit Arrangements

As a result of the Restructuring, the Company's existing bank credit facilities were replaced by a $650.0 million five-year working capital and letter of credit facility (the Facility), bearing interest at variable rates. The Facility places certain restrictions on the level of funds available and is reduced by $40.0 million annually beginning December 31, 1988.

At July 30, 1988, $375.0 million, of which approximately $350.0 million was collateralized by customer accounts receivable, was borrowed under the Facility. Subsequent to year end, the Company chose to amend the Facility to mature on August 4, 1989, in anticipation of a restructuring of the related debt.

Carter Hawley Hale Finance Subsidiaries

Credit Corp. is a wholly-owned, consolidated subsidiary of the Company. During the third quarter of 1986, substantially all net assets of two other wholly-owned finance subsidiaries, CHH Finance Corp. and Carter Hawley Hale Overseas Finance N.V., were distributed to the Company pursuant to a plan to liquidate those subsidiaries.

Net earnings of the finance subsidiaries were $5.3 million in 1988, $2.9 million in 1987, $8.5 million in 1986, and $14.1 million in 1985. The combined balance sheet of the finance subsidiaries, which reflects the elimination of all intercompany items, is presented below:

(In millions)	July 30, 1988	August 1, 1987
Assets		
Customer accounts purchased from Carter Hawley Hale Stores, Inc.,	$ 4.7	$149.6
less 10 percent withheld pending collection and settlement of discount	6.0	83.1
Due from Carter Hawley Hale Stores, Inc.		.2
Cash and other assets	$ 10.7	$232.9
Liabilities and Investment of Carter Hawley Hale Stores, Inc.		$ 5.0
Accrued liabilities		175.2
8.45–12.00 percent Notes	$ 4.0	5.0
8.95 percent Subordinated Notes due 1989–1992	6.7	47.7
Investment of Carter Hawley Hale Stores, Inc.	$ 10.7	$232.9

Contingencies

The Company is a defendant in certain legal actions. In the opinion of management, the disposition of these actions will not have a material adverse effect upon the Company's financial position or results of operations.

Retirement and Profit Sharing Plans

The Company has several qualified noncontributory pension plans covering substantially all employees. Employees who have completed one year of employment, are at least 21 years of age, and are not covered by a collectively bargained pension plan, are covered by the plans and become vested for benefit purposes after completing ten years of employment with the Company. The Company also has unfunded nonqualified pension plans covering certain employees. Each year the Company contributes at least the actuarially determined minimum amount necessary to fund participants' benefits in accordance with the requirements of the Employee Retirement Income Security Act of 1974 plus additional amounts which may be approved by the Company from time to time. Plan assets are invested in equity and fixed income securities.

Pension expense and the funded status of plans, based on actuarial information estimated as of June 30, 1988 and 1987, and December 31, 1986, are as follows:

(In millions)	1988	1987	1986
Net periodic pension expense			
Service costs	$ 5.9	$ 2.5	$ 5.0
Interest cost on projected benefit obligation	13.0	5.7	11.9
Actual net loss (return) on assets	2.8	(9.7)	(10.9)
Net amortization (deferral)	(11.5)	6.4	3.3
	$ 10.2	$ 4.9	$ 9.3
Funded status of plans			
Accumulated benefit obligation			
Vested	$(133.3)	$(127.3)	$(139.0)
Nonvested	(9.3)	(8.7)	(9.8)
	(142.6)	(136.0)	(148.8)
Additional amounts relating to projected compensation increase	(23.7)	(19.8)	(20.7)
Actuarial present value of projected benefit obligations	(166.3)	(155.8)	(169.5)
Market value of plan assets	92.6	105.2	110.6
Funded status	(73.7)	(50.6)	(58.9)
Unrecognized net obligation at initial date of application of FAS No. 87	37.6	41.0	44.8
Unrecognized net loss	29.1	11.5	19.8
Prepaid pension expense (pension liability)	$ (7.0)	$ 1.9	$ 5.7
Significant actuarial assumptions			
Discount rate			
Beginning of year	9.0%	9.0%	10.0%
End of year	9.0	9.0	9.0
Long-term rate of return on assets	11.0	11.0	11.0
Projected rate of compensation increases	5.0	5.0	5.0

Pension expense for 1985, which was not restated to a FAS No. 87 basis, amounted to $9.2 million and included an interest rate assumption of 9.0 percent.

In addition, the Company provides certain health care and life insurance benefits for retired employees. Substantially all of the Company's employees may become eligible for those benefits if they reach normal retirement age while working for the Company. The cost of retiree health care and life insurance benefits is recognized as expense as claims are paid and was $2.5 million in 1988, $1.2 million in 1987, $2.2 million in 1986 and $1.6 million in 1985.

A contributory Profit Sharing Plan is available to substantially all employees who have completed one year of service. Effective July 1, 1987, the Plan was amended to provide that the Company will contribute an amount which is the greater of 3 percent of consolidated pretax earnings (as defined in the Plan agreement) or an amount which is at least equal to 25 percent of employee contributions. Employee and Company contributions are used to buy shares of the Company's common stock at prevailing market prices. Company contributions to the Plan were $2.8 million in 1988, $.7 million in 1987, $4.3 million in 1986, and $2.2 million in 1985. The Plan, at July 30, 1988, held 9.4 million shares representing 41 percent of the Company's common stock outstanding.

As part of the Restructuring, the Company and The Neiman-Marcus Group entered into an Employee Benefits Agreement which provides that The Neiman-Marcus Group will be responsible for 50 percent of the unfunded liabilities which were accrued prior to the Restructuring and were attributable to the Company's corporate employees (including employees of the Information Services and Market Services divisions), under the pension, deferred compensation, and medical and life insurance plans. The agreement also provides that the Company and The Neiman-Marcus Group jointly and unconditionally guarantee the unfunded liabilities accrued prior to the Restructuring for corporate employees under the nonqualified pension plan and the deferred compensation plan. Such guarantee shall continue in effect until the Company's net worth exceeds $300 million.

Employee Stock Incentive Plans

In August 1987, shareholders approved the 1987 Stock Incentive Plan (the Plan) which provides that key employees (Participants) may be granted stock options (with or without limited stock appreciation rights), stock purchase rights, and restricted stock awards up to an aggregate of 2.2 million shares through March 31, 1997. During 1988, 1.8 million shares were issued under the Plan at prices ranging from $6.4690 to $13.6625 per share including .9 million stock purchase rights and .9 million restricted stock awards. The shares issued in connection with stock purchase rights were issued in exchange for nonrecourse notes which become due in six years and bear interest at rates ranging from 8.15 percent to 9.54 percent. The shares issued in connection with restricted stock awards were issued at no cost to the Participant. The shares vest in six years and then only if the Participant remains continuously employed by the Company. In most cases, exercise of restricted stock awards are also subject to Participants exercising their related stock purchase rights. At July 30, 1988, $12.3 million of nonrecourse notes outstanding, relating to the stock purchase rights, and $10.6 million of unamortized costs relating to the restricted stock awards were reflected as a contra to shareholders' equity. The cost of the restricted stock awards is being amortized by the Company over the vesting period. The amount amortized to expense in 1988 was $1.8 million.

Other Company stock option plans in existence at the time of the Restructuring provided that key employees may be granted options to purchase common stock of the Company at not less than the market price on the date of grant. Options may be exercised over a ten-year period generally beginning one year from the date of grant. Options held immediately prior to the Restructuring by active employees were converted into options for Company shares or The Neiman-Marcus Group shares, depending upon whether the holder remained in the employ of the Company or The Neiman-Marcus Group. Options held by retirees and former employees of the Company were converted into options for shares of the Company and The Neiman-Marcus Group. The number of shares and exercise prices relating to such options were adjusted to reflect the relative trading prices of the Company and The Neiman-Marcus Group shares during an adjustment period. At July 30, 1988, options for 3.7 million Company shares were outstanding under these plans at prices ranging from $2.67 to $7.30, of which options for 2.9 million shares were exercisable. Subsequent to the Restructuring no new options will be granted under these plans.

Common Stock and Other Shareholders' Equity

As part of the Restructuring the par value of common stock was changed from $5.00 per share to $.01 per share and the authorized common stock outstanding was increased from 60 million to 100 million shares. At July 30, 1988, 4.1 million shares were reserved under the employee stock incentive plans and 2.0 million shares were reserved for purchase by the Profit Sharing Plan.

On August 26, 1987, the Company declared a dividend of one Preferred Stock Purchase Right (the Right) for each outstanding share of common stock. The Rights expire 10 years after issuance, and are exercisable only if a person or group (other than the Profit Sharing Plan) acquires 20 percent or more of the Company's common stock or commences a tender or exchange offer which would result in the acquisition of 30 percent or more of the Company's common stock. Each Right entitles the holder to purchase one newly-issued unit of preferred stock at an exercise price of $60.

Under certain circumstances, as provided in the Rights Plan, each Right entitles the holder to purchase, at the exercise price, common stock of the Company or an acquiring company at a value equal to twice the exercise price. The Company may redeem the Rights at $.02 per Right at any time prior to 10 days after the acquisition of 20 percent of the Company's common stock.

Redeemable Preferred Stock

The authorized preferred stock of the Company consists of five million shares $.01 par value of which no amounts were reserved or outstanding at July 30, 1988. As part of the Restructuring, one million shares of preferred stock held by General Cinema Corporation were converted into common and preferred shares of The Neiman-Marcus Group.

Company and Independent Accountant Reports

Company Report on Responsibility for Financial Statements

The integrity and objectivity of the financial statements, including estimates and judgments inherent in the preparation of financial information and the selection of appropriate accounting principles, are the responsibilities of the Company, as is all other information included in this Annual Report.

The Company maintains a system of internal accounting controls, supported by documentation, to provide reasonable assurance that assets are safeguarded and that the books and records reflect the authorized transactions of the Company. Limitations exist in any system of internal accounting controls based upon the recognition that the cost of the system should not exceed the benefits derived. The Company believes its system of internal accounting controls, augmented by its internal auditing function, appropriately balances the cost/benefit relationship. The system provides for the prevention or detection of material errors and has been implemented and supported by written policies and guidelines, the internal audit function, a division of responsibility in organizational arrangements, and the selection and training of qualified personnel.

The financial statements have been examined by our independent accountants in accordance with generally accepted auditing standards in order that they might render their independent professional opinion, which is presented below. To express their opinion, independent accountants develop and maintain an understanding of the accounting and financial systems and controls, conduct tests, and employ such related audit procedures as they consider necessary.

The Audit Committee of the Board of Directors, composed solely of outside directors, meets periodically with the independent accountants, management, and internal auditors to discuss accounting principles, financial and accounting controls, the scope of the annual audit, internal audit, and other matters. Management's selection of independent accountants is reviewed by this committee and the independent accountants and the internal auditors have complete access to it, without management present, to discuss results of their audit and their opinions on adequacy of internal controls, quality of financial reporting, and any other matters of interest.

Report of Independent Accountants

To the Board of Directors and Shareholders of
Carter Hawley Hale Stores, Inc.

Price Waterhouse

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of earnings, cash flows, and common stock and other shareholders' equity present fairly, in all material respects, the financial position of Carter Hawley Hale Stores, Inc. and its consolidated subsidiaries at July 30, 1988 and August 1, 1987, and the results of their operations and their cash flows for the fiscal year ended July 30, 1988, for the twenty-six week period ended August 1, 1987 and for each of the two fiscal years in the period ended January 31, 1987, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

As discussed in the Changes in Accounting Policies section of the Summary of Significant Accounting Policies, the Company changed its method of accounting for certain indirect costs incurred in the acquisition of merchandise inventories in fiscal 1988 and its method of accounting for costs incurred in the development of computer software for internal use in fiscal 1986. We concur with the changes in accounting.

Price Waterhouse

400 South Hope Street
Los Angeles, California
October 5, 1988

Quarterly Information (Unaudited)

(In millions, except per share data)

1988 (Fifty-two weeks ended July 30, 1988)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
Sales	$610.6	$865.9	$546.1	$594.5	$2,617.1
Cost of goods sold, including occupancy and buying costs	433.2	628.5	382.8	435.1	1,879.6
Selling, general, and administrative expenses	148.3	167.3	135.0	137.3	587.9
Gain on sale of shopping center interest				30.0	30.0
Costs of operational and facility realignment programs				28.5	28.5
Earnings from continuing operations before interest expense and income taxes	29.1	70.1	28.3	23.6	151.1
Interest expense	28.1	36.1	35.6	35.8	135.6
Pretax earnings (loss) from operations	1.0	34.0	(7.3)	(12.2)	15.5
Income taxes	.4	13.6	(2.9)	(4.9)	6.2
Earnings (loss) from operations	.6	20.4	(4.4)	(7.3)	9.3
Extraordinary item				(1.7)	(1.7)
Change in accounting	10.1				10.1
Net earnings (loss)	$ 10.7	$ 20.4	$ (4.4)	$ (9.0)	$ 17.7
Primary earnings (loss) per common share*					
Operations	$ (.06)	$ .94	$ (.20)	$ (.35)	$ .33
Extraordinary item				(.08)	(.08)
Change in accounting	.46				.47
	$ .40	$ .94	$ (.20)	$ (.43)	$ .72

1987 (Twenty-six weeks ended August 1, 1987)	First Quarter	Second Quarter	Twenty-six Week Period
Sales	$569.8	$ 594.5	$1,164.3
Cost of goods sold, including occupancy and buying costs	404.4	515.4	919.8
Selling, general, and administrative expenses	137.8	211.4	349.2
Costs of operational and facility realignment programs		15.7	15.7
Loss on sale of John Wanamaker		4.0	4.0
Direct restructuring costs		15.7	15.7
Other restructuring costs		7.4	7.4
Earnings (loss) from continuing operations before interest expense and income taxes	27.6	(175.1)	(147.5)
Interest expense	13.8	14.3	28.1
Pretax earnings (loss) from continuing operations	13.8	(189.4)	(175.6)
Income taxes	6.1	(74.4)	(68.3)
Earnings (loss) from continuing operations	7.7	(115.0)	(107.3)
Discontinued operations, net of tax	10.2	(73.8)	(63.6)
Net earnings (loss)	$ 17.9	$(188.8)	$ (170.9)
Primary earnings (loss) per common share*			
Continuing operations	$ .01	$ (6.04)	$ (6.06)
Discontinued operations	.49	(3.64)	(3.15)
	$ .50	$ (9.68)	$ (9.21)

1986 (Fifty two weeks ended January 31, 1987)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
	(In millions, except per share data)				
Sales	$629.9	$661.2	$709.8	$995.1	$2,996.0
Cost of goods sold, including occupancy and buying costs	451.9	473.5	509.5	733.8	2,168.7
Selling, general, and administrative expenses	148.2	153.8	178.8	204.9	685.7
Loss on sale of John Wanamaker				2.2	2.2
Direct restructuring costs				25.0	25.0
Earnings from continuing operations before interest expense and income taxes	29.8	33.9	21.5	29.2	114.4
Interest expense	22.4	21.3	19.4	19.8	82.9
Pretax earnings from continuing operations	7.4	12.6	2.1	9.4	31.5
Income taxes	2.5	4.5	.9	18.6	26.5
Earnings (loss) from continuing operations	4.9	8.1	1.2	(9.2)	5.0
Discontinued operations, net of tax	9.6	3.5	15.2	14.3	42.6
Extraordinary item				(29.3)	(29.3)
Change in accounting	(14.1)				(14.1)
Net earnings (loss)	$ .4	$ 11.6	$ 16.4	$ (24.2)	$ 4.2
Primary earnings (loss) per common share*					
Continuing operations	$ (.13)	$ .03	$ (.31)	$ (.83)	$ (1.23)
Discontinued operations	.48	.17	.75	.71	2.10
Extraordinary item				(1.46)	(1.44)
Change in accounting	(.70)				(.70)
	$ (.35)	$ .20	$ .44	$ (1.58)	$ (1.27)

* The calculation of fully diluted earnings per common share had no dilutive effect and is not disclosed.

Closing Market Price Ranges of Common Stock	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
1988 (46 weeks ended July 30, 1988)(1)	$15¼– 6⅞	$10½– 7	$12 – 9⅛	$10¾– 9	$15¼– 6⅞
1988 (6 weeks ended September 12, 1987)(1)	$77 –69				$77 –69
1987 (26 weeks ended August 1, 1987)	$62⅞–51⅞	$71⅛–60¼			$71⅛–51⅞
1986 (52 weeks ended January 31, 1987)	$34⅞–29	$38 –29⅜	$39 –33⅞	$55 –39⅝	$55 –29
1985 (52 weeks ended February 1, 1986)	$28½–25	$30⅞–27½	$29½–24½	$35⅝–26½	$35⅝–24½

The New York Stock Exchange is the principal market on which the Common Stock is traded.

(1) The Common Stock of the Company traded at a pre-restructuring price up to and including the week ended September 12, 1987. Shareholders of record as of September 8, 1987, subject to certain election procedures, retained their common stock of the Company and also received $17 in cash and one share of The Neiman-Marcus Group for each share of Company common stock held.

Five Year Financial Summary

(Dollar amounts in thousands, except per share data)	1988[2]	1987[1]	1986[2]	1985[2]	1984[3]	1983[2]
For the Year						
Sales	$2,617,143	$1,164,338	$2,995,977	$2,889,950	$2,749,910	$2,304,784
Percent increase from prior year	7[8]	5.8[7]	3.7	5.1	19.3	18.3
Cost of goods sold, including occupancy and buying costs	1,879,664	919,764	2,168,653	2,123,185	2,057,170	1,706,868
Selling, general, and administrative expenses	587,869	349,185	685,680	660,346	618,717	513,184
Unusual (income) expense[4]	(1,500)	42,850	27,200		7,100	(17,020)
Earnings (loss) from continuing operations before interest expense and income taxes	151,110	(147,461)	114,444	106,419	66,923	101,752
Interest expense	135,600	28,134	82,915	91,203	86,209	70,580
Pretax earnings (loss) from continuing operations	15,510	(175,595)	31,529	15,216	(19,286)	31,172
Income taxes	6,200	(68,300)	26,500	(3,000)	(15,900)	5,300
Earnings (loss) from continuing operations	9,310	(107,295)	5,029	18,216	(3,386)	25,872
Discontinued operations, net of income taxes[5]		(63,578)	42,586	29,809	93,056	41,613
Extraordinary item and changes in accounting[6]	8,350		(43,401)			
Net earnings (loss)	$ 17,660	$ (170,873)	$ 4,214	$ 48,025	$ 89,670	$ 67,485
Cash dividends	$ 2,055	$ 21,155	$ 54,255	$ 53,638	$ 50,129	$ 43,454
Per Common Share						
Primary earnings (loss) from continuing operations*	$ .33	$ (6.06)	$ (1.23)	$ (.60)	$ (1.34)	$ .71
Cash dividends		.305	1.22	1.22	1.22	1.22

(Dollar amounts in thousands)	1988(2)	1987(1)	1986(2)	1985(2)	1984(3)	1983(2)
At Year End						
Accounts and other receivables, net (including accounts sold)	$ 473,826	$ 546,819	$ 520,696	$ 656,644	$ 678,672	$ 642,095
Merchandise inventories	536,656	432,866	497,924	550,239	497,499	406,459
Owned property and equipment, net	472,658	411,905	440,213	480,847	436,707	418,746
Leased property under capital leases, net	63,003	90,178	96,879	108,965	115,145	121,474
Total assets	1,671,622	1,922,086	1,905,807	2,116,410	2,012,704	2,072,865
Long-term debt	1,177,248	769,820	527,452	570,088	558,782	605,551
Capital lease obligations	83,168	112,042	119,783	135,033	140,656	146,310
Redeemable preferred stock		300,000	300,000	300,000	300,000	
Nonredeemable preferred stock, common stock, and other shareholders' equity	(230,191)	145,772	324,207	359,354	348,166	783,533
Common shares outstanding (in thousands)	22,592	20,367	20,042	19,559	19,067	35,341
Common shareholders	20,984	16,211	9,951	12,205	10,692	13,182
Employees	35,000	35,000	35,000	45,000	45,000	41,000

(1) Twenty-six weeks.
(2) Fifty-two weeks.
(3) Fifty-three weeks.
(4) Includes gain on sale of shopping center interest of $30.0 million in 1988, costs for operational and facility realignment programs of $28.5 million in 1988 and $15.7 million in 1987, loss on sale of John Wanamaker of $4.0 million in 1987 and $2.2 million in 1986, costs relating to the restructuring program of $23.1 million in 1987 and $25.0 million in 1986, tender offer costs of $7.1 million in 1984, gains on sale of joint venture interests of $12.8 million in 1983, and gain on retirements of debentures of $4.2 million in 1983.
(5) Includes gain on sale of Waldenbooks of $63.0 million, net of income taxes, in 1984.
(6) Includes income from change in accounting for capitalization of certain inventory costs of $10.1 million in 1988, costs relating to early retirement of debt of $1.7 million in 1988 and $29.3 million in 1986, and charge for change in accounting for computer software development costs of $14.1 million in 1986.
(7) John Wanamaker excluded from prior year sales.
(8) Sales increase on a comparative twelve month basis, excluding from prior year sales of John Wanamaker and two Broadway-Southwest stores, which were sold.

* The calculation of fully diluted earnings per common share had no dilutive effect and is not disclosed.

Store Square Footage Report

	1988	1987	1986	1985	1984	1983
The Broadway–Southern California						
Number	43	43	43	41	40	40
Store space	7,459	7,459	7,459	7,101	6,971	6,971
The Broadway–Southwest						
Number	11	11	13	12	10	10
Store space	1,744	1,744	2,012	1,877	1,609	1,609
Emporium Capwell						
Number	22	22	22	22	22	21
Store space	5,260	5,260	5,268	5,246	5,246	5,065
Thalhimers						
Number	24	24	24	25	25	26
Store space	2,624	2,637	2,637	2,588	2,445	2,507
Weinstock's						
Number	12	12	12	12	12	12
Store space	1,935	1,935	1,935	1,935	1,935	1,935
Total Department Stores						
Number	112	112	114	112	109	109
Store space	19,022	19,035	19,311	18,747	18,206	18,087

Information as of year end. Gross store space in thousands of square feet.

Directors

Caroline Leonetti Ahmanson	Chairman of the Board of Caroline Leonetti Ltd. Director since 1987. (3,4,5)
Robert O. Anderson	President and Chief Executive Officer of Pauley Petroleum Inc. Director since 1975. (4)
Norman Barker, Jr.	Former Chairman of the Board of First Interstate Bank of California and Vice Chairman of First Interstate Bancorp. Director since 1970. (1,2,3)
Benjamin F. Biaggini	Chairman Retired of Southern Pacific Company. Director since 1983. (2,3,5)
Waldo H. Burnside	President and Chief Operating Officer of Carter Hawley Hale Stores, Inc. Director since 1980. (1)
Edward W. Carter	Chairman of the Board Emeritus of Carter Hawley Hale Stores, Inc. Director since 1946. (1)
Myron Du Bain	Chairman of the Board of SRI International. Director since 1987. (2,4,5)
Walter B. Gerken	Chairman of the Executive Committee of Pacific Mutual Life Insurance Company. Director since 1977. (1,3,4,5)
Prentis C. Hale	Former Chairman of the Board of Carter Hawley Hale Stores, Inc. Director since 1949. (5)
Philip M. Hawley	Chairman of the Board and Chief Executive Officer of Carter Hawley Hale Stores, Inc. Director since 1970. (1)
Harold J. Haynes	Senior Counselor to the Bechtel Group, Inc. Director since 1977. (1,2,3,4)
Donn B. Miller	Partner in the Los Angeles-based law firm of O'Melveny & Myers. Director since 1974. (1)
Dennis C. Stanfill	President of Stanfill, Bowen & Co., Inc. Director since 1987. (1,2,3)
William B. Thalhimer, Jr.	Chairman of the Board of Thalhimer Brothers, Incorporated, a subsidiary of Carter Hawley Hale Stores, Inc. Director since 1978. (1,5)

(1) Executive Committee
(2) Audit Committee
(3) Compensation Committee
(4) Nominating Committee
(5) Public Policy Committee

Corporate Officers

Philip M. Hawley	Chairman of the Board & Chief Executive Officer
Waldo H. Burnside	President & Chief Operating Officer
Loyd E. Ellis	Executive Vice President
John M. Gailys	Executive Vice President & Chief Financial Officer
Paul E. Chevalier	Senior Vice President, Employee Relations
Brian L. Fleming	Senior Vice President, Accounting & Taxes
Edwin J. Holman	Senior Vice President, Operations
J. Scott Meyer	Senior Vice President, Store Planning & Construction
Larry G. Petersen	Senior Vice President, Planning
Thomas E. Brown	Vice President, Credit
D. Clair Brumbaugh	Vice President, Income Tax
John F. Busey	Vice President, Treasurer
Arthur G. Coons	Vice President, Marketing
Theodore J. Cotti	Vice President, Human Resource Development
William E. Dombrowski	Vice President, Corporate Affairs
Robert J. Gilmartin	Vice President, Real Estate
Serena S. Kokjer	Vice President, Management Information Services
Joel E. Montgomery	Vice President, Human Resource Services
Gary J. Peterson	Vice President, Distribution
E. Harlin Smith	Vice President, Investor Relations
Dale G. Thune	Vice President, Property & Sales Tax
Robert L. Turner	Vice President, Construction
Walter W. Tuthill	Vice President, General Auditor
Collette F. Ventrone	Vice President, Store Planning
Edward A. Wolfe	Vice President, Loss Prevention
James L. Vandeberg	Secretary & Corporate Counsel

Division Management

Department Stores

The Broadway–Southern California
H. Michael Hecht, Chairman & CEO
Richard F. Clayton, President

The Broadway–Southwest
Martin M. Kalkstein, President & CEO

Emporium Capwell
Stewart M. Kasen, President & CEO
Jack L. Richardson, Chairman

Thalhimers
William B. Thalhimer, Jr, Chairman
Michael C. Weisberg, President & CEO

Weinstock's
Cheryl Nido Turpin, Chairman & CEO

Support Divisions

Information Services
R. Vincent Conant, Chairman & CEO
Robert M. Menar, President

Market Services
Gregory C. Crews, President & CEO

Shareholder Information

Executive Offices	550 South Flower Street, Los Angeles, California 90071, Telephone: (213) 620-0150
Common Stock	Symbol: CHH, New York Stock Exchange, Pacific Stock Exchange, London Stock Exchange
Transfer Agent	Security Pacific National Bank, Corporate Services Division, 2-70, P.O. Box 60228, Terminal Annex, Los Angeles, California 90060
Independent Accountants	Price Waterhouse
General Counsel	O'Melveny & Myers, Los Angeles
Form 10-K	A copy of the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission is available upon request to: The Secretary, Carter Hawley Hale Stores, Inc., 550 South Flower Street, Los Angeles, California 90071.

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